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Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-927

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Petitioner,

v.

INVESTMENT COMPANY INSTITUTE,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF OF THE AMERICAN BANKERS ASSOCIATION, THE NEW YORK CLEARING HOUSE ASSOCIATION, BANKAMERICA CORPORATION, AND WESTERN BANCORPORATION AS *AMICI CURIAE*

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INTEREST OF *AMICI CURIAE*

The American Bankers Association, The New York Clearing House Association, BankAmerica Corporation, and Western Bancorporation, with the consent of the parties, submit this brief *amici curiae* in support of the petitioner. The *amici* have a substantial and immediate interest in this case, which presents an important question concerning the meaning and application of two major federal banking statutes. The American Bankers

Association is the principal trade association of the commercial banking industry. The New York Clearing House Association is an association of twelve major commercial banks, each of which is owned by a bank holding company subject to regulation by the Federal Reserve Board. BankAmerica Corporation and Western Bancorporation are bank holding companies subject to regulation by the Board; each has a nonbanking subsidiary that serves as investment adviser to a registered closed-end investment company pursuant to the regulation the validity of which is at issue in this case.

QUESTION PRESENTED

Whether the Federal Reserve Board's adoption of a regulation and interpretive ruling that permit bank holding companies and their nonbank subsidiaries, subject to specified limitations, to sponsor, organize, manage, and control closed-end investment companies is a valid exercise of the Board's authority under section 4(c)(8) of the Bank Holding Company Act and is consistent with the constraints imposed on the activities of bank holding companies by the Glass-Steagall Act.

STATEMENT

1. *Investment companies and investment advisers.* An investment company is a "corporate or business trust medium which pools the investment funds of many persons, generally of moderate means, and invests these pooled investment funds in a diversified portfolio of securities . . . under continuous professional supervision." [1] Investment companies can be either "open-end" or "closed-end." Open-end investment companies (commonly called "mutual funds") are, typically, continuously engaged in

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[1] Investment Company Institute, *Management Investment Companies* 1 (1962).

raising new capital through the issuance of additional shares; they stand ready at any time to redeem their outstanding shares. By contrast, closed-end investment companies have an essentially fixed capitalization and, typically, do not issue additional shares after their initial organization; they do not stand ready to redeem their shares.[2]

Most investment companies are organized and managed by their investment advisers. An investment adviser regularly furnishes investment advice to, or determines the securities or other property to be purchased or sold by, the investment company. In addition, it generally maintains records, handles administrative matters, and performs management tasks:

> The management of [an investment company] is largely in the hands of an investment adviser, an independent entity which generally organizes the fund and provides it with investment advice, management services, and office space and staff. The adviser either selects or recommends the fund's investments and rate of portfolio turnover, and operates or supervises most of the other phases of the fund's business.[3]

2. *The Board's adoption of the regulation.* A "bank holding company" is a company that has control over a bank. Section 2(a)(1) of the Bank Holding Company Act of 1956, *as amended*, 12 U.S.C. § 1841(a)(1). Section 4(a) of the Bank Holding Company Act prohibits a bank holding company from acquiring ownership of any entity other than a bank or from engaging in any business other than banking. 12 U.S.C. § 1843(a). Section 4(c)(8) of the Act, however, authorizes the Board

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[2] *See, e.g., id.* at 3; 12 C.F.R. § 225.125(c).

[3] *Tannenbaum* v. *Zeller*, 552 F.2d 402, 405 (2d Cir. 1977). *See generally* 1 T. Frankel, *The Regulation Of Money Managers* 6-21 (1978).

of Governors of the Federal Reserve System to except from that prohibition activities the Board "has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto." 12 U.S.C. § 1843(c)(8).

After notice and hearing,[4] the Board determined, by regulation, that "serving as investment adviser, as defined in § 2(a)(20) of the Investment Company Act of 1940, to an investment company registered under that Act" is "closely related to banking" within the meaning of section 4(c)(8) of the Bank Holding Company Act. 12 C.F.R. § 225.4(a)(5)(ii), 37 Fed. Reg. 1463 (Jan. 29, 1972). At the same time, the Board issued an interpretive ruling specifying what activities were prohibited, and what activities were allowed, to bank holding companies or their nonbank subsidiaries serving as investment advisers.[5]

The Board prohibited two classes of activities. *First*, in order to avoid "potential conflicts of interests," the Board prohibited bank holding companies (as well as their bank and nonbank subsidiaries) from purchasing for their own or for discretionary accounts securities of the investment companies they advise, extending credit to such investment companies, or accepting securities of such investment companies as collateral for loans for the purchase of additional securities of those investment companies. 12 C.F.R. § 225.125(g).[6] *Second*, the Board

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[4] *See* 36 Fed. Reg. 16695 (Aug. 25, 1971) (notice of proposed rulemaking); 36 Fed. Reg. 20779 (Oct. 29, 1971) (hearing held and comments received).

[5] Except where the context indicates otherwise, the expression "bank holding company" will be used to include both the holding company and its nonbank subsidiaries.

[6] The Board imposed additional prohibitions to deal with "potential conflicts of interests" that it felt might arise in

prohibited a bank holding company from "engag[ing], directly or indirectly, in the sale or distribution of securities of any investment company for which it acts as investment adviser." 12 C.F.R. § 225.125(h). The Board stated that a bank holding company may not distribute sales literature of the investment company or make such literature available at its offices, and that personnel of the holding company's bank subsidiaries may not express any opinion on the advisability of purchasing the investment company's securities. 12 C.F.R. § 225.125(h).[7]

Subject to those limitations, the Board allowed a bank holding company serving as investment adviser to a closed-end investment company to perform the full range of functions traditionally performed by such advisers (including sponsoring, organizing, managing, and controlling the closed-end investment company), provided that the closed-end investment company is not "primarily or frequently engaged in the issuance, sale and distribution of securities." 12 C.F.R. § 225.125(f).[8]

3. *The Board's denials of respondent's petitions for reconsideration.* In December 1973 and again in March 1977, respondent Investment Company Institute, a trade association of open-end investment companies, petitioned

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situations where a bank holding company acts both as custodian and investment adviser for an investment company. 12 C.F.R. § 225.125(i).

[7] In addition, the Board prohibited a bank holding company from acting as investment adviser to an investment company that, either because of its name or office location, might be identified with the bank holding company or any of its subsidiary banks. 12 C.F.R. §§ 225.125(f), (h).

[8] The Board also allowed bank holding companies to serve as investment advisers to open-end investment companies, but did not authorize them to sponsor, organize, manage, or control such companies. 12 C.F.R. § 225.125(f).

the Board to reconsider and rescind its determination that serving as an investment adviser is "closely related to banking" within the meaning of section 4(c)(8) of the Bank Holding Company Act. The Board denied both petitions.[9]

Respondent's principal argument before the Board was that bank holding companies would violate section 21 of the Glass-Steagall Act, 12 U.S.C. § 378, if they served as investment advisers. The Board disagreed, stating that the prohibitions contained in section 21 apply only to banks, not to bank holding companies,[10] and that in any event the specific activities permitted to bank holding companies under its regulation are not prohibited to banks:

> In considering the permissibility of investment advisory activity for bank holding companies, the Board was especially careful to limit the scope of the permitted activity to investment advisory services, which has been a traditional banking function as long as there have been banks.

Pet. App. D, p. 57a. Respondent also argued that banks would violate section 16 of the Glass-Steagall Act, 12

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[9] Pet. App. D, pp. 53a-64a; Pet. App. E, pp. 65a-79a. Following the Board's denial of the first petition, respondent sought review in the United States District Court for the District of Columbia. The district court dismissed the action on the ground that exclusive jurisdiction lay in the courts of appeals, and the court of appeals affirmed. *Investment Company Institute* v. *Board of Governors*, 398 F. Supp. 725 (D.D.C. 1975), *aff'd*, 551 F.2d 1270 (D.C. Cir. 1977). Respondent thereupon filed its second petition with the Board.

[10] In this connection, the Board noted that Congress, in enacting the 1970 amendments to the Bank Holding Company Act, "clearly" intended to empower the Board "to authorize bank holding companies to engage in activities that could not be conducted by banks directly." Pet. App. D, p. 56a.

U.S.C. § 24 Seventh, if they acted as investment advisers, but the Board pointed out that its regulation authorized only nonbank entities in the holding company system to act as investment advisers. Pet. App. D, pp. 60a-61a.

As for that part of its regulation dealing specifically with closed-end investment companies, the Board stated:

> [B]ank holding companies may affiliate with closed-end investment companies only "as long as such companies are not primarily or frequently engaged in the issuance, sale and distribution of securities."] This is consistent with—and even stricter than—the provision of section 20 of the Glass-Steagall Act which merely prohibits affiliations with a member bank where a [bank holding] company is "engaged principally" in securities activities.

Pet. App. E, p. 77a. At no time had respondent urged that the Board's regulation was inconsistent with section 20 of the Glass-Steagall Act.

4. *The court of appeals' decision.* Upon review, the United States Court of Appeals for the District of Columbia Circuit invalidated the Board's regulation and ruling. The court did not disapprove the Board's factual determination that serving as an investment adviser to a closed-end investment company is "closely related to banking" within the meaning of section 4(c)(8) of the Bank Holding Company Act. Instead, the court concluded that the regulation lay outside the Board's power under the Bank Holding Company Act.

The court of appeals believed that the Board's regulation conflicted with the "Glass-Steagall Act's overarching policy," Pet. App. A, p. 30a, which the court apparently viewed as barring banks and their affiliates from engaging in what it classified broadly as "the securities business" or "securities activities." *See, e.g.*, Pet. App. A, pp. 28a, 43a. The court did not determine,

however, that the Board's regulation and ruling authorized bank holding companies to engage in activities prohibited to them by the Glass-Steagall Act. The court held that the regulation was consistent with sections 16 and 21 of the Act.[11] The court "intimate[d] no views" as to the applicability of sections 20 and 32 of the Act. *Id.* at 44a. Nor did the court decide that the regulation would have violated former section 19(e) of the Glass-Steagall Act, had that provision not earlier been repealed. *Id.* at 23a.

The court's holding nevertheless reflected its view of former section 19(e). The court appeared to derive from that provision an implicit, nontextual limitation on the Board's power under section 4(c)(8) of the Bank Holding Company Act. *See id.* at 29a-32a, 43a.

The court of appeals thus treated the actual reach of the Glass-Steagall Act as immaterial. In the court's view, what was "important" to its inquiry was not what the Glass-Steagall Act's language stated, but rather "what subsequent Congresses *thought* that Act to have meant." *Id.* at 28a (emphasis in original). The court concluded that later Congresses "*perceived* the Glass-Steagall Act as prohibiting securities activities by bank holding companies and their non-bank subsidiaries." *Id.* at 44a (emphasis in original); *see also id.* at 31a. The court recognized that "Congress may have been mistaken in its perception," but regarded that possibility as irrelevant to the issues before it. *Id.* at 44a.

Because neither party had suggested the line of analysis followed by the court, *see id.* at 24a, the Board was

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[11] *Id.* at 14a-23a. The court held that the prohibitions of section 21 of the Glass-Steagall Act apply only to banks and not to bank holding companies or their nonbank subsidiaries. *Id.* at 17a-20a. As for section 16, the court noted that respondent had conceded that it applied "only [to] the activities of banks, and not of other entities within the holding company structure." *Id.* at 21a.

unable to address the court's approach until it filed a petition for rehearing. The court denied the petition but, *sua sponte*, modified its opinion to state that it was not deciding "the question of whether bank holding companies and their non-bank subsidiaries may . . . render solely investment advice to closed-end investment companies, as distinct from sponsoring, organizing, managing, or controlling such companies." *Id.* at 48a-49a.

INTRODUCTION AND SUMMARY OF ARGUMENT

The sole issue in this case is the validity of a regulation and interpretive ruling by which the Federal Reserve Board, pursuant to its authority of section 4(c)(8) of the Bank Holding Company Act, authorized bank holding companies to serve as investment advisers to closed-end investment companies, and in that capacity to perform (subject to specified limitations) the functions customarily performed by investment advisers. 12 C.F.R. §§ 225.4(a)(5)(ii), 225.125. The regulation and ruling rested upon the Board's determination that serving as investment adviser to an investment company registered under the Investment Company Act of 1940 is "so closely related to banking . . . as to be a proper incident thereto" within the meaning of section 4(c)(8).

There is no dispute as to the correctness of the Board's factual determination. As the Board noted, Pet. App. D, p. 57a, banks have long performed the kinds of functions that the Board has authorized bank holding companies to perform for closed-end investment companies. Banks sponsored and managed closed-end investment companies both before and after enactment of the Glass-Steagall Act.[12] In addition, banks have long operated common trust and commingled pension funds,

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[12] SEC, *Report on Investment Trusts and Investment Companies, Part 2*, H.R. Doc. No. 70, 76th Cong., 1st Sess. 57-59, 124 (Table 25) (1939) (*"Investment Company Report"*).

which function like investment companies,[13] and banks have traditionally offered a full range of investment advisory and management services to such funds. Those services include organizing the fund (including bearing the costs of organization and obtaining necessary authorizations for the fund to do business); performing record-keeping and other administrative responsibilities; managing the fund's investment portfolio (including establishing the fund's investment policies, rendering investment advice to and making investment decisions for the fund, and retaining brokers and issuing orders for purchases and sales of securities); arranging for audits and satisfying reporting requirements; and generally exercising exclusive management of the fund.[14]

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[13] *See* H. Bullock, *The Story Of Investment Companies* 75 (1959); 1 T. Frankel, *supra* n.3, at 422-23; SEC, *Report on Investment Trusts and Investment Companies, Supplemental Report on Commingled or Common Trust Funds Administered by Banks and Trust Companies*, H.R. Doc. No. 476, 76th Cong., 1st Sess. 3-4 (1939). The Board formally authorized national banks to organize and manage common trust funds in 1937, and since then over forty states have adopted laws permitting state chartered banks to operate such funds. *Id.* at 25; *see also, e.g.*, 7 U.L.A. Business & Fin. Laws 15 (Supp. 1980) (Uniform Common Trust Fund Act). In 1955, the Board further permitted banks to commingle the trust assets of their pension and employee benefit plan clients. 20 Fed. Reg. 3305 (May 14, 1955), 12 C.F.R. § 9.18(a)(2). By the time the Board promulgated the regulations challenged in this case, the nation's 50 largest banks had organized and were actively managing over 350 common trust funds and commingled pension funds. SEC, *Institutional Investor Study Report*, H.R. Doc. No. 64, 92d Cong., 1st Sess. 417 (Table V-1) (1971).

[14] Banks perform a number of these services pursuant to requirements of state and federal law. *See, e.g.*, 12 C.F.R. §§ 9.18(b)(1)-(12); I.R.C. § 6032; N.Y. Banking Law § 100-c (McKinney 1971); N.Y. Banking Board, General Regulations, ch. I, part 22.

In organizing, operating, and managing common trust and commingled pension funds, banks provide investment advisory services of the kind that the Board has authorized bank holding companies to perform. The issue presented here is whether, notwithstanding the close relationship between the activities authorized by the Board and those in which banks routinely engage, the Board lacks authority under section 4(c)(8) to permit bank holding companies to engage in such activities.

* * * * *

The Board's regulation was well within the broad authority conferred by section 4(c)(8) of the Bank Holding Company Act, and nothing in the Glass-Steagall Act renders the Board's regulation invalid.

1. The Board's regulation is consistent with the Glass-Steagall Act. Sections 16 and 21 of that Act, 12 U.S.C. §§ 24 Seventh and 378, apply only to banks, not to bank holding companies. Section 20 of the Glass-Steagall Act, 12 U.S.C. § 377, which is the sole provision of the Act that limits the activities of bank holding companies, prohibits such companies only from engaging "principally" in "the issue, flotation, underwriting, public sale, or distribution" of securities. Neither an investment adviser nor an investment company operating under the Board's regulation runs afoul of this provision.

A bank holding company that serves as investment adviser to a closed-end investment company in the manner authorized by the Board is not engaged at all, let alone "principally," in the activities forbidden to bank affiliates by section 20 of the Glass-Steagall Act. The statutory phrase "issue, flotation, underwriting, public sale, or distribution" of securities refers to securities underwriting activities of the kind traditionally conducted by investment banking houses. *Board of Governors* v. *Agnew*, 329 U.S. 441, 445 & n.3 (1947). Under the Board's regulation and ruling, a bank holding company

may not engage in such activities. The ruling expressly prohibits a bank holding company from "engag[ing], directly or indirectly, in the sale or distribution of securities of any investment company for which it acts as investment adviser." 12 C.F.R. § 225.125(h).

Nor is a closed-end investment company for which a bank holding company may serve as investment adviser "engaged principally" in the activities described in section 20 of the Glass-Steagall Act. By their very nature, closed-end investment companies are not "principally" engaged in the underwriting, distribution, or issuance of securities; indeed, their distinguishing feature is that they do not regularly issue shares. 12 C.F.R. § 225.125 (c). Furthermore, the Board's ruling allows bank holding companies to organize and manage only closed-end investment companies that are "not primarily or frequently engaged in the issuance, sale and distribution of securities." 12 C.F.R. § 225.125(f).

Section 10(c) of the Investment Company Act of 1940, 15 U.S.C. § 80a-10(c), confirms that closed-end investment companies are not "engaged principally" in the activities described in section 20 of the Glass-Steagall Act. In section 10(c), Congress approved the continuation of existing affiliations between banks and closed-end investment companies—something it would not have done if such affiliate relationships were barred by the Glass-Steagall Act. Congress' decision to allow banks to participate in the management of closed-end investment companies expresses a policy that supports, rather than conflicts with, the Board's determination.

2. The challenged regulation lies well within the Board's authority under section 4(c)(8) of the Bank Holding Company Act. In that provision, Congress, relying upon the Board's expertise and familiarity with the banking industry, granted the Board broad power to permit bank holding companies to engage in those nonbank-

ing activities that the Board finds to be "closely related to banking." Section 4(c)(8) contains no special limitations with respect to securities activities. The legislative history of the Bank Holding Company Act and its amendments does not suggest any implied, nontextual limitation on the Board's authority. Nor can such a limitation be derived from former section 19(e) of the Glass-Steagall Act.

ARGUMENT

THE BOARD'S REGULATION PERMITTING BANK HOLDING COMPANIES TO ORGANIZE, SPONSOR, MANAGE, AND CONTROL CLOSED-END INVESTMENT COMPANIES IS VALID

The Board's regulation and ruling were adopted pursuant to section 4(c)(8) of the Bank Holding Company Act, which confers broad authority upon the Board to permit bank holding companies to engage in activities "so closely related to banking . . . as to be a proper incident thereto." The focus of this litigation throughout, however, has been on the Glass-Steagall Act. Respondent's principal arguments have been that the activities permitted by the Board violate prohibitions of the Glass-Steagall Act, *see* pp. 6-9 *supra*, and the decision of the court of appeals is rooted in the court's understanding that "the Glass-Steagall Act's overarching policy" was to "divorc[e] investment from commercial banking." Pet. App. A, p. 30a.

The court's description of the "policy" of the Glass-Steagall Act was oversimplified: although the Act proscribes the underwriting of non-governmental securities by banks, the statute specifically permits banks to engage in the underwriting of governmental securities.[15] In any

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[15] Congress has allowed banks to underwrite "obligations of the United States [and] general obligations of any state or of any political subdivision thereof," and also obliga-

event, even the "policy" identified by the court of appeals would not be affronted by what the Board has done here: an investment company is not an investment bank, and a bank holding company is not a commercial bank. Moreover, a legislative policy is applied by enforcing "the language of the statute itself." *Transamerica Mortgage Advisers* v. *Lewis*, 100 S.Ct. 242, 245 (1979). And nothing in the language of the Glass-Steagall Act prohibits the activities that the Board has authorized bank holding companies to perform.

I. The Glass-Steagall Act Does Not Prohibit A Bank Holding Company From Serving As Investment Adviser To A Closed-End Investment Company In The Manner Authorized By The Board

A. *The Only Provision Of The Glass-Steagall Act That Imposes Restrictions On The Activities Of Bank Holding Companies Is Section 20*

The Glass-Steagall Act contains four distinct provisions designed to achieve the objective of separating commercial banking from the underwriting of nongovernmental securities:

> (1) section 16 of the Act, 12 U.S.C. § 24 Seventh, prohibits a national or state member bank from engaging in the underwriting of nongovernmental securities and from dealing in such securities for its own account;[16]
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> (2) section 21 of the Act, 12 U.S.C. § 378, prohibits any person engaged in the business of "issuing, underwriting, selling, or distributing" non-

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tions issued under a wide variety of state and federal programs and obligations issued by certain international agencies. *See* 12 U.S.C. § 24 Seventh.

[16] By its terms, section 16 applies only to national banks. Section 5(c) of the Glass-Steagall Act, 12 U.S.C. § 335, makes section 16 applicable to state member banks.

governmental securities from engaging "to any degree whatever" in commercial banking;

(3) section 20 of the Act, 12 U.S.C. § 377, prohibits "affiliation" [17] between a member bank and any person engaged "principally" in the "issue, flotation, underwriting, public sale, or distribution" of securities; and

(4) section 32 of the Act, 12 U.S.C. § 78, prohibits officer, director or employee interlocks between a member bank and a company engaged "primarily" in the activities described in section 20.

In addition, former section 19(e) of the Act, 48 Stat. 188, which was repealed in 166, 80 Stat. 242-43, prohibited a bank holding company from voting the shares of any bank if the holding company also held an interest in a company engaged "principally" in the activities described in section 20.

Thus, in the Glass-Steagall Act Congress carefully distinguished between banks and bank affiliates and prescribed different rules for each. Whereas in sections 16 and 21 Congress prohibited banks from *any* involvement in the underwriting of non-governmental securities and from dealing in such activities as a principal,[17] Congress chose not to impose such sweeping prohibitions on the securities activities of bank affiliates. Section 20,

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[17] Section 2(b) of the Glass-Steagall Act, 12 U.S.C. § 221a(b), defines "affiliate" as any entity (1) owned or controlled by the bank, (2) under common control with the bank, (3) a majority of whose directors also are directors of the bank, or (4) that owns or controls the bank. The fourth category, of course, covers a bank holding company; the second category covers, *inter alia*, a bank holding company's nonbanking subsidiaries. The fourth category was added by amendment in 1966. 80 Stat. 242-43. Before 1966, therefore, section 20 applied to a bank holding company's nonbanking subsidiaries but not directly to a bank holding company itself.

which deals directly with bank affiliates, prohibits such affiliates only from engaging "principally" in issuing, underwriting, selling, or distributing securities. The qualifying term "principally" "mark[s] a distinction which . . . should not [be] obliterate[d]. . . ." *Board of Governors* v. *Agnew*, 329 U.S. 441, 448 (1947).[18]

Sections 16 and 21 of the Glass-Steagall Act have no application here. The Board's regulation grants no authority to banks. Pet. App. A, pp. 22a-23a. It authorizes certain bank *affiliates* to sponsor, organize, manage, and control closed-end investment companies. Respondent has conceded that section 16 places no restrictions on bank holding companies or other bank affiliates, *id.* at 21a, and both the Board and the court of appeals correctly de-

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[18] The court of appeals wrongly suggested, Pet. App. A, p. 26a, that Congress did not mean to draw a significant distinction between banks and bank affiliates in the Glass-Steagall Act. *See Board of Governors* v. *Agnew*, 329 U.S. at 447-48. The legislative history of the Glass-Steagall Act demonstrates that Congress used the term "principally" in section 20 with full awareness of the distinction it signified. As initially proposed, section 21 of the Glass-Steagall Act prohibited various business organizations "engaged *principally* in the business of issuing, underwriting, selling, or distributing" securities from also being involved in commercial banking. S. 1631, 73d Cong., 1st Sess. § 21(a)(1) (May 1, 1933) (emphasis added). *Accord*, H.R. 5661, 73d Cong., 1st Sess. § 17(a)(1) (May 17, 1933). The word "principally" was stricken from this provision in a floor amendment offered by Senator Bulkley, a major proponent of the bill, who was concerned that, as proposed, the provision might not achieve the aim of separating commercial banking from the underwriting of non-governmental securities. *See* 77 Cong. Rec. 4180 (1933). In contrast, Congress retained the term "principally" in section 20, thereby making clear that that provision did not impose on bank affiliates the absolute prohibition that was made applicable to banks themselves.

termined that section 21 also applies only to banks and not to bank affiliates. Pet. App. D, pp. 54a-56a; Pet. App. A, pp. 14a-21a.[19]

Section 20, which does apply to bank affiliates, provides that

> no member bank shall be affiliated . . . with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities. . . .

Section 20 is the sole provision of the Glass-Steagall Act that imposes restrictions on the business activities of bank affiliates.[20] To the extent that the Glass-Steagall Act articulates a congressional policy concerning the conduct of securities activities by bank affiliates, that policy is expressed by section 20. Neither that policy nor the express prohibitions of section 20 are contravened by the Board's regulation.

B. *An Investment Adviser Operating Within The Limits Prescribed By The Board Is Not Engaged Principally In The Activities Described In Section 20 Of The Glass-Steagall Act*

An investment adviser that operates within the limits prescribed by the Board is not engaged principally in "the issue, flotation, underwriting, public sale, or distri-

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[19] Because sections 16 and 21 of the Glass-Steagall Act do not apply to bank holding companies, this case differs significantly from *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971), which involved the application of those provisions to banks.

[20] The focus of section 32 of the Act is on the existence of director and employee interlocks between a bank and a company that, whether or not otherwise affiliated with the bank, is "primarily" engaged in the underwriting activities also described in section 20.

bution" of securities within the meaning of section 20 of the Glass-Steagall Act. This Court already has had occasion, in its decision in *Board of Governors* v. *Agnew*, to construe this statutory phrase, which appears in both section 20 and section 32 of the Act: contrary to the apparent understanding of the court of appeals, Pet. App. A, p. 44a, the statutory phrase does not cover all securities activities, or even "the brokerage business," but only "the underwriting field." 329 U.S. at 445 & n.3.[21] Consistent with this reading, the Board has long taken the position that "executing orders for the purchase and sale of securities on behalf of others in the open market" does not constitute "the issue, flotation, underwriting, public sale, or distribution" of securities within the meaning of the Glass-Steagall Act. 12 C.F.R. § 218.1 n.1 (derived from 12 C.F.R. § 218.1 n.95 (1939)).

This Court's determination in *Agnew* that the statute refers specifically to underwriting activities and not to securities activities generally is grounded in the statu-

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[21] The issue in *Agnew* was whether Eastman, Dillon & Co. was "primarily" engaged in "the issue, flotation, underwriting, public sale, or distribution" of securities within the meaning of section 32. The firm's major business activity was brokerage, but it also was significantly involved in underwriting; together, the two securities activities produced well over 50 percent of the firm's gross income. 329 U.S. at 445. This Court understood that brokerage was not included among the securities activities described in the statute; the Court specifically addressed the question whether Eastman, Dillon was "primarily" engaged "in underwriting" even though its "underwriting business did not by any quantitative test exceed 50 per cent of its total business . . . ." 329 U.S. at 446. The Court concluded that "[i]f the underwriting business of a firm is substantial, the firm is engaged in the underwriting business in a primary way, though by any quantitative test underwriting may not be its chief or principal activity." *Id.*

tory language itself, the legislative history of section 20, and the informed contemporaneous understanding of the Glass-Steagall Act. The statutory phrase "issue, flotation, underwriting, public sale, or distribution" of securities precisely describes the securities underwriting activities of investment bankers.[22] This language derived from an earlier legislative proposal drafted by the Federal Reserve Board, the purpose of which was "to separate commercial banking from investment banking."[23] Section 20

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[22] The only word that might seem out of place today when discussing investment banking is "issue." But at the time the statute was drafted, investment banking was frequently described as the business of "originating" or "issuing" the securities of others, just as investment banking houses were then referred to as "houses of issue." *See, e.g., Hearings Pursuant to S. Res. 71 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 71st Cong., 3d Sess. 35, 241 (1931) ("*S. Res. 71 Hearings*"); *Hearing on S. 4115 Before the Senate Comm. on Banking and Currency*, 72d Cong., 1st Sess. 28, 33 (1932) ("*S. 4115 Hearings*"); S. Rep. No. 1455, 73d Cong., 2d Sess. 117 (1934); 75 Cong. Rec. 9909 (1932). Thus, each word in the statutory phrase was designed to connote the origination, distribution, and marketing of securities for a profit—the investment banking business. *See generally* 1 L. Loss, *Securities Regulation* 160, 164, 167 n.14 (1961).

[23] *S. 4115 Hearings, supra* n.22 at 393 (statement of Governor Meyer of the Federal Reserve Board). *See also id.* at 385, 388, and 417. Senate hearings held the previous year had shown that bank "securities affiliates" that engaged in investment banking operations formed one of the chief connections between commercial banks and the securities markets. *S. Res. 71 Hearings, supra* n.22, at 999. Although some of these affiliates engaged in a wide variety of functions, they were generally in the business of acting either as wholesalers of securities issues (by purchasing entire offerings themselves or by joining with other similar companies to acquire whole issues of securities) or as retailers of securities (by distributing securities to institutional and private investors). *Id.* at 1057-60; 75 Cong. Rec. 9909 (1932).

itself was specifically intended to terminate affiliations between banks and "corporations operating in the long-term capital market in competition with the investment houses, typically unincorporated, that have traditionally done most of the business in that market." [24] The subsequent study by the Securities and Exchange Commission that led to the enactment of the Investment Company Act in 1940 also expressed the same understanding—that section 20 barred banks from affiliating with securities firms "comparable to houses of issue," *i.e.*, "[f]irms whose primary business was the origination of securities in connection with their primary distribution." *Investment Company Report, supra* n.12, at 57 & n.38 (definition of "bank affiliate"). Thus there was ample basis and reason for this Court's determination that "[s]ection 20 of the Act outlaws affiliation of a member bank with an organization 'engaged principally' in the *underwriting* business." *Board of Governors* v. *Agnew*, 329 U.S. at 447 (emphasis added; footnote omitted).[25]

A bank holding company that serves as investment adviser to a closed-end investment company in the manner authorized by the Board is not engaged at all, let alone "principally," in the securities underwriting activities described in section 20 of the Glass-Steagall Act. The Board's regulations expressly prohibit a bank holding company from "engag[ing], directly or indirectly, in the sale or distribution of securities of any investment company for which it acts as investment adviser." 12

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[24] 75 Cong. Rec. 9909 (1932) (discussion by Senator Bulkley of section 18 of S.4412, 72d Cong., 1st Sess. (1932), which was the predecessor of section 20 of the Glass-Steagall Act).

[25] Mr. Justice Douglas, who wrote the opinion of the Court in *Agnew*, had been Chairman of the SEC at the time of the SEC study that culminated in the *Investment Company Report*.

C.F.R. § 225.125(h). The task of underwriting, distributing, and maintaining a market for the investment company's shares is therefore left to "an independent underwriting firm" that performs these functions under contract. Pet. App. D, pp. 56a-57a. The bank holding company plays no role in "the issue, flotation, underwriting, public sale, or distribution" of any securities.

In addition, the investment adviser to a closed-end investment company is insulated from the "promotional and other pressures incidental to the operation of an investment fund . . ." found to exist in *Investment Company Institute* v. *Camp*, 401 U.S. at 637.[26] As the Board has explained,

> in the case of a closed-end fund, there are no such promotional pressures on the adviser because the fund's growth results principally from increase in asset value, rather than from external growth. Therefore, the adviser's economic incentive to increase its compensation is accomplished by furnishing superior investment advice, rather than engaging in sales activities.

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[26] Respondent's counsel conceded in hearings before the Board that the organization and management of a closed-end investment company would not entail a serious risk of conflict of interest arising from promotional activities:

> In our judgment, the most serious of those conflicts of interest relate to this promotional aspect, this concern by the bank or its affiliates in constantly selling the shares, and that, as I say, is not typical of a closed-end company. So, I would have to be frank to say to you that the serious conflicts that we see are not present with respect to closed-end companies.

Transcript of Hearing before the Board of Governors of the Federal Reserve System on Bank Holding Companies to Serve as Investment Advisers to Investment Companies 15 (Nov. 12, 1971) (remarks of G. Duane Vieth).

Pet. App. D, p. 58a. The Board, moreover, has prohibited bank holding companies and their subsidiaries from engaging in promotional activity:

> Prospectuses or sales literature should not be distributed by the holding company, nor should any literature be made available to the public at any offices of the holding company. In addition, officers and employees of bank subsidiaries should be instructed not to express any opinion with respect to advisability of purchase of securities of any investment company for which the bank holding company acts as investment adviser. Customers of banks in a bank holding company system who request information on an unsolicited basis regarding any investment company for which the bank holding company acts as investment adviser, may be furnished the name and address of the fund and its underwriter or distributing company, but the names of bank customers should not be furnished by the bank holding company to the fund or its distributor.

12 C.F.R. § 225.125(h). As a consequence of these restrictions, a bank holding company that serves as an investment adviser will stand completely apart from the process of underwriting and distributing shares. That is all (indeed, more than) section 20 of the Glass-Steagall Act requires.

Even if the Board had not imposed these restrictions, the holding company's service as an investment adviser to a closed-end investment company still would not violate section 20. Serving as an investment adviser entails no activities beyond those permitted to the investment company itself, and a closed-end investment company of the type described in the Board's interpretive ruling does not engage "principally in the issue, flotation, underwriting, public sale, or distribution" of securities within the meaning of section 20.

C. *Under The Board's Interpretive Ruling, A Bank Holding Company May Organize, Sponsor, Manage, And Control Only Investment Companies That Are Not Engaged Principally In The Activities Described In Section 20 Of The Glass-Steagall Act*

The Board's regulations permit bank holding companies to organize, sponsor, manage, and control only closed-end investment companies registered under the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1, *et seq.* Such companies are not principally engaged in the securities underwriting activities described in section 20 of the Glass-Steagall Act.[27]

As a matter of law, registered investment companies may not engage principally in underwriting and distributing the securities of other issuers. Section 3(c)(2) of the Investment Company Act, 15 U.S.C. § 20a-3 (c)(2), excludes from the definition of "investment company" any firm that is "primarily engaged in the business of underwriting and distributing securities issued by other persons, selling securities to customers, and acting as a broker, or any one or more of such activities . . . ."[28] *And see Board of Governors* v. *Agnew*, 329 U.S. at 446 (a firm cannot be engaged "principally" in an activity in which it is not even "primarily" engaged).

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[27] Whether a closed-end investment company advised by a bank holding company is an "affiliate" for the purposes of section 20 is a question of mixed law and fact that could only be decided on a case-by-case basis. For purposes of the discussion here, however, we assume *arguendo* that such a closed-end investment company would be an affiliate subject to the strictures of section 20.

[28] An entity excluded from the statutory definition of "investment company" may not elect to be treated as such a company for purposes of the Investment Company Act. *See* 1 T. Frankel, *supra* n.3, at 354.

In addition, closed-end investment companies are not engaged principally in issuing or distributing their own shares:[29] "a closed-end investment company typically does not issue shares after its initial organization except at infrequent intervals and does not stand ready to redeem its shares." 12 C.F.R. § 225.125(c). A closed-end investment company is, therefore, no more engaged in the issue or distribution of securities than is any other business corporation:

> Since a closed-end company is under no obligation to redeem, that is, buy back its own shares, its capital structure is much like that of companies in other areas of the economy. Equity capital contributed by the public is viewed as permanently committed to the enterprise . . . . The company is not engaged in a continuous quest for new capital.

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[29] There is of course a significant difference between the securities underwriting activity addressed by section 20 and the occasional issuance by a corporation of its own shares: the former activity is a source of income, the latter only a source of capital. Securities underwriting firms derive their income through the success of their promotions; the earnings generated by an underwriting depend upon the number of the issuer's securities that the underwriter succeeds in selling and the spread between the price that the underwriter pays the issuer and the amount that it receives for the securities that it sells. *See generally United States* v. *Morgan*, 118 F.Supp. 621, 650-55 (S.D.N.Y. 1953). In contrast, a business corporation issues its own securities simply to attract additional capital to the enterprise. The corporation's income is generated through the use of that capital and not by the process of raising it. In particular, the earnings of a closed-end investment company derive solely from the capital appreciation, dividends, and interest produced by its investments and not from promotional and sales activities. *See* SEC, *Report on the Public Policy Implications of Investment Company Growth*, H.R. Rep. No. 2337, 89th Cong., 2d Sess. 43 (1966) (*"Public Policy Implications"*).

Public Policy Implications, *supra* n.29, at 42-43. Because a closed-end investment company is a basically static investment vehicle, it differs significantly from an open-end investment company, or "mutual fund," which "is continuously engaged in issuing its shares and stands ready at any time to redeem them." Pet. App. A, p. 6a.[30]

Closed-end investment companies, therefore, by their very nature are not "engaged principally" in the activities described in section 20 of the Glass-Steagall Act. But even if an occasional closed-end investment company, because of its aberrant mode of operation, arguably could be said to be "engaged principally" in those activities, *cf.* 12 C.F.R. § 218.104(d), the validity of the Board's regulation would not be affected. The Board's regulation is not self-executing. A bank holding company must apply individually for permission to serve as investment adviser to an investment company, and the Board determines on a case-by-case basis whether granting the application "can reasonably be expected to produce benefits to the public . . . that outweigh possible adverse affects . . . ." 12 U.S.C. § 1843(c)(8). *See, e.g.*, *Independent Bankers Ass'n of Georgia* v. *Board of Governors*, 516 F.2d 1206, 1215-16 (D.C. Cir. 1975). The Board can and should inquire, upon administrative consideration of specific applications, whether peculiar operating features of a particular closed-end investment company raise a question under section 20 of the Glass-Steagall Act. No such inquiry is presented by judicial review of the bare bones of the regulation.

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[30] For the same reason, closed-end investment companies also differ significantly from the bank-operated collective investment funds that this Court recognized to be essentially equivalent to mutual funds in *Investment Company Institute* v. *Camp*, 401 U.S. at 625.

The only question here is whether the activities authorized by the regulation on its face are consistent with the applicable statutes. The Board has eliminated any possibility of conflict between its regulation and the Glass-Steagall Act by providing that bank holding companies may sponsor, organize, manage, and control only those closed-end investment companies that "are not primarily or frequently engaged in the issuance, sale and distribution of securities." 12 C.F.R. § 225.125(f). This restriction is, as the Board noted, "consistent with—and even stricter than—the provision of section 20 of the Glass-Steagall Act which . . . prohibits affiliation with a member bank [only] where a company is 'engaged principally' in [the] securities activities [described therein]." Pet. App. E, p. 77a.

The Board's regulation would be valid even in the absence of this limitation. The circumstances surrounding the enactment of the Glass-Steagall Act and subsequent legislative developments demonstrate that Congress has consistently recognized and understood that the Act does not prohibit banks from affiliating with, or even sponsoring and managing, closed-end investment companies. At the time of the enactment of the Glass-Steagall Act, there were in operation well over 100 closed-end investment companies (or, as they were then commonly known, "investment trusts").[31] Twelve closed-end investment companies, with assets exceeding $70 million, were sponsored and managed by banks.[32] These

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[31] *See* H. Bullock, *The Story Of Investment Companies* 73 (1959); *Investment Company Report, supra* n.12, at 57, 124 (Table 25). During the 1920's and 1930's closed-end investment companies were far more common than open-end companies. *See, e.g., Public Policy Implications, supra* n.29, at 43-44.

[32] *Investment Company Report, supra* n.12, at 57, 124 (Table 25).

investment companies continued to be sponsored and managed by banks after passage of the Glass-Steagall Act, with no suggestion by Congress, the SEC, or anyone else that the continued affiliations might violate section 20.[33]

When Congress specifically turned its attention to investment companies only a few years later, it approved the continuation of existing affiliations between banks and closed-end investment companies.[34] Section 10(c) of the Investment Company Act of 1940, 54 Stat. 806, which prospectively barred a registered investment company from having "a majority of its board of directors consisting of persons who are officers or directors

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[33] *Id.* The court of appeals misread the *Investment Company Report* as providing "indirect evidence that at least the industry viewed the Glass-Steagall Act as broadly prohibiting such activity." Pet. App. A, p. 28a n.30. The court overlooked the fact that the *Report* showed banks had continued to sponsor closed-end investment companies after the enactment of the Glass-Steagall Act. *See Investment Company Report, supra* n.12, at 57 n.38, 59, 124 (Table 25). The court cited as "evidence" the fact that, following enactment of the Glass-Steagall Act, closed-end investment companies were no longer sponsored by "bank securities affiliates." The reason for this, however, is that the term "bank securities affiliates," as used in the *Report*, referred to a category of entities (*i.e.*, investment banking houses) affiliated with banks that had been legislated out of existence by the Glass-Steagall Act. *Id.* at 57 n.38.

[34] There were no bank-sponsored open-end investment companies in 1940. *In the Matter of First National City Bank*, ICA Rel. No. 4538, [1964-66 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,332, at 82,589 (March 9, 1966), *aff'd sub nom. National Ass'n of Securities Dealers, Inc.* v. *SEC*, 420 F.2d 83 (D.C. Cir. 1969), *vacated sub nom. Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971).

of any one bank," contained a "grandfather clause" for existing majority interlocks:

> [I]f on March 15, 1940, any registered investment company shall have had a majority of its directors consisting of persons who are directors, officers, or employees of any one bank, such registered company may continue to have the same percentage of its board of directors consisting of persons who are directors, officers, or employees of such bank.

The purpose of this grandfather clause was to permit the existing bank-managed closed-end investment companies to continue in operation.[35] Congress would not have condoned the operation of these bank-managed companies, and certainly would not have enacted a grandfather clause approving their continued operation, if it had believed that such operation had been and would continue to be in violation of the Glass-Steagall Act or contrary to its "overarching policy."

Even apart from the grandfather clause, section 10(c) of the Investment Company Act demonstrates that closed-end investment companies are not "engaged principally in the issue, flotation, underwriting, public sale, or distribution" of securities within the meaning of section 20 of the Glass-Steagall Act. At the time of the enactment of section 10(c), 15 U.S.C. § 80a-10(c), section 32 of the Glass-Steagall Act already prohibited

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[35] During its consideration of section 10(c), Congress was specifically advised by the SEC that banks were continuing to sponsor closed-end investment companies and that existing law allowed "an interlocking majority" of directors between banks and investment companies. The SEC recommended the use of a grandfather clause in order not to disrupt "the delicate relationship between banks and investment companies." *Hearings on S. 3580 before a Subcomm. of the Senate Comm. on Banking and Currency*, 76th Cong., 3d Sess. 885-86 (1940) ("*Hearings on S. 3580*").

any officer, director, or employee of a member bank from serving as an officer, director, or employee of a company "primarily engaged" in the securities activities described in section 20.[36] But section 10(c) of the Investment Company Act *permits* minority interlocks between banks and investment companies and explicitly authorized the continuation of then-existing majority interlocks. If closed-end investment companies were even "primarily engaged" (and *a fortiori* if they were "engaged principally") in the securities underwriting activities described in section 20 of the Glass-Steagall Act, then section 32 of that Act and section 10(c) of the Investment Company Act would always have been in conflict as to such companies. The legislative history of section 10(c), however, is devoid of evidence that Congress perceived such a conflict. Nor does it contain evidence that Congress viewed the existing interlocking relationships permitted by section 10(c) as having previously been unlawful. *See* n.35 *supra.*

The significance of section 10(c) of the Investment Company Act goes beyond merely demonstrating that Congress, in legislating with respect to investment companies in 1940, acted on the basis of its understanding that a closed-end investment company is neither "engaged principally" nor "primarily engaged" in the securities underwriting activities described in sections 20 and 32 of the Glass-Steagall Act. Section 10(c) is also an affirmative expression of congressional policy regarding the relationships between banks and investment com-

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[36] As originally enacted in 1933, section 32 had barred such interlocking relationships between member banks and companies "engaged primarily in the business of purchasing, selling, or negotiating securities." 48 Stat. 194. In 1935, section 32 was amended to conform its language to that of section 20. 49 Stat. 709. *See* H.R. Rep. No. 742, 74th Cong., 1st Sess. 17 (1935).

panies: section 10(c) plainly contemplates that banks themselves may and will participate in the management of investment companies.[37] It allows a bank to have its officers, directors, and employees serve on the board of directors of an investment company, provided only that they do not comprise a majority of the board. And it places no restrictions whatever on the extent to which the bank-affiliated directors may be involved in the management, control, supervision, and operation of the investment company. Thus, when Congress explicitly focused its attention on the subject, it determined that within the limits allowed by the prohibition against majority interlocks, banks could not only affiliate with, but also lawfully participate in the management of, closed-end investment companies.

II. The Board Properly Determined That Serving As An Investment Adviser To A Closed-End Investment Company Is Closely Related To Banking Within The Meaning Of Section 4(c)(8) Of The Bank Holding Company Act

A. *The Board Has Broad Authority To Determine The Nonbanking Activities In Which Bank Holding Companies May Engage*

Section 4 of the Bank Holding Company Act of 1956, *as amended*, 12 U.S.C. § 1843, represents the principal legislative effort to define the activities in which bank holding companies may lawfully engage. It expresses Congress' judgment that although the business of bank holding companies properly centers upon banking, such companies may also engage in a variety of non-banking

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[37] Section 10(c) represented "a middle-road between no regulation and complete segregation" of banks from the management of investment companies. *Hearings on S. 3580, supra* n.35, at 217.

activities. In section 4, Congress employed the familiar device of a broad prohibition followed by specific exceptions. Section 4(a) by its terms purports to bar bank holding companies from engaging in any activities other than banking, but section 4(c) lists several exceptions to that general prohibition. For example, bank holding companies are authorized, as banks are not, to purchase securities—including shares of registered investment companies—for their own accounts. Sections 4(c)(6) and (7) of the Act, 12 U.S.C. §§ 1843(c)(6) and (7).

Congress recognized that a list of specific exceptions would not do full justice to the complexity of the industry it was seeking to regulate. Congress also understood that it lacked sufficient information and expertise to determine the full range of nonbanking activities that may be closely related to banking and therefore appropriate for a bank holding company:

> [C]ertain activities of a financial, fiduciary, or insurance nature are obviously so closely related to banking as to require no divestment by a bank holding company. . . . However, there are many other activities of a financial, fiduciary, or insurance nature which cannot be determined to be closely related to banking without a careful examination of the particular type of business carried on under such activity. For this reason your committee deems it advisable to provide a forum before an appropriate Federal authority in which decisions concerning the relationship of such activities to banking can be determined in each case on its merits.

S. Rep. No. 1095, 84th Cong., 1st Sess. 13 (1955). Consequently, Congress chose to delegate to the Board responsibility for determining the extent to which bank holding companies would be permitted to engage in nonbanking activities other than those specifically identified in section 4(c).

Section 4(c)(8) grants this authority to the Board in sweeping terms. It provides that the general prohibition contained in section 4(a) "shall not apply to . . . activities . . . which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto." This statutory language makes clear that the Board has been granted broad power to designate, in the exercise of its informed discretion, the nonbanking activities in which bank holding companies may engage. The standard to be applied by the Board is that the activity in question must be "so closely related to banking . . . as to be a proper incident thereto." Congress left to the Board the responsibility for determining, on the basis of the Board's expertise and familiarity with the banking industry, the proper content of the statutory standard.

Congress thus delegated to the Board with an open hand, relying upon the Board's superior fact-finding ability and expertise in banking matters for a discriminating evaluation of the extent to which bank holding companies should be permitted to engage in nonbanking activities. In doing so, Congress did not place any special limitation on the Board's power to authorize bank holding companies to engage in securities-related activities that are also "closely related to banking." In particular, Congress did not seek to bar the Board from permitting bank holding companies to serve as investment advisers to closed-end investment companies; rather, Congress left this issue, like many others, for resolution by the Board.

Congress did not contract the scope of the Board's authority when it amended the Bank Holding Company Act in 1970.[38] To be sure, efforts were made to add a "laun-

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[38] If anything, the 1970 amendments enlarged the Board's authority. In those amendments, Congress substituted the word "banking" for the phrase "business of banking" in

dry list" of limitations on the Board's authority, including a provision that would have barred the Board from permitting bank holding companies to engage *at all* in securities activities of the type described in section 20 of the Glass-Steagall Act.[39] The conference committee deleted this laundry list in its entirety, however, thereby leaving the Board's authority unchanged with respect to securities activities as well as other activities.[40]

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section 4(c)(8) in order to make clear that the Board may permit a bank holding company to engage in nonbanking activities whether or not those activities relate to the operations of the holding company's banking subsidiaries. H.R. Rep. No. 1747, 91st Cong., 2d Sess. 15-16 (1970) (Statement of House Managers).

[39] *See* H.R. 6778, 91st Cong., 1st Sess. § 1(f), 115 Cong. Rec. 33154 (1969); 115 Cong. Rec. 32897, 32902-03, 33133-34 (1969).

[40] In a colloquy on the Senate floor, Senator Sparkman, Chairman of the Committee on Banking and Currency, emphasized that the action of the Conference Committee, and the language of the bill as reported from the conference, simply left standing the existing provisions of the Glass-Steagall Act:

> As it now stands, the Glass-Steagall Act broadly prohibits both banks and their affiliates from engaging in what we commonly understand to be the securities business. *There are some specific exceptions,* of course, but I can assure you that *we did not mean to enlarge or contract them here* . . . . In short, we did not intend to amend or modify, directly or indirectly any limitations on the activities of banks, bank-holding companies or any of their affiliates, now contained in the Glass-Steagall Act.

116 Cong. Rec. 42430 (1970) (emphasis added).

B. *In Determining That Bank Holding Companies May Serve As Investment Advisers To Closed-End Investment Companies, The Board Acted Well Within The Statutory Constraints On Its Authority*

The Board's authority under section 4(c)(8) is subject only to two relevant statutory constraints. First, the Board's factual determination of what activities are "so closely related to banking . . . as to be closely related thereto" is solely within the province of the Board, subject only to judicial review to protect against arbitrary or capricious administrative action. 5 U.S.C. § 706. This constraint is not pertinent here. The Board's determination that serving as an investment adviser to a closed-end investment company is "so closely related to banking" was factually correct, pp. 9-11 *supra*, and respondent has not suggested that the Board acted arbitrarily or capriciously.[41] The court of appeals was not confronted with that issue, and it is not before this Court.

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[41] In adopting the regulation, the Board carefully and extensively considered all relevant factual and legal issues. The Board heard oral testimony during two days of hearings and received written comments from a variety of interested persons. Following its review of the comments received and the record of the hearing, the Board not only promulgated the regulation initially proposed, in an amended form, but also issued an interpretive ruling that painstakingly protected against potential abuses and hazards that had been identified. Subsequently, the Board twice responded, thoughtfully and in detail, to respondent's objections. This therefore is not a case where the agency "adopted no expressly articulated position at the administrative level . . . [or] promulgated [its regulation] without opinion or accompanying statement." *Investment Company Institute* v. *Camp*, 401 U.S. at 627. To the contrary, the Board's decision was thoroughly reasoned and fully explained.

Second, the Board's authority is constrained by the terms of the Glass-Steagall Act. Section 4(c)(8) of the Bank Holding Company Act empowers the Board to exempt activities only from the prohibition of section 4(a), not from statutory prohibitions expressed elsewhere; thus, the Board may not permit bank holding companies to engage in activities that are expressly forbidden to them by the Glass-Steagall Act. *See* 12 C.F.R. § 225.125 (b).[42] The only section of that Act which limits the business activities open to bank holding companies is section 20, and the Board's regulations do not authorize bank holding companies to engage in activities that would violate that provision. *See* pp. 14-17 *supra*.

The opinion below suggests, although without squarely holding, that the Board's authority is subject to a third, implicit, statutory constraint derived from former section 19(e) of the Glass-Steagall Act, 48 Stat. 188. Section 19(e) had been repealed more than five years before the Board adopted its regulation. 80 Stat. 242-43 (1966). The court of appeals appeared to reason, however, that in enacting the Bank Holding Company Act in 1956 Congress, with section 19(e) in mind, had intended to place a continuing nontextual limitation on the Board's authority under section 4(c)(8).

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[42] In this Court, respondent argued for the first time that the Board may not permit bank holding companies to engage in activities that are forbidden to *banks* by the Glass-Steagall Act. *See* Br. in Opp. 7-8, 15-16. But the very purpose of section 4(c)(8) is to empower the Board to authorize holding companies to engage in activities that are not permitted to banks under section 4(a). *See* p. 6 n.10 *supra*. This relationship is confirmed by section 4(a)(2), which provides that bank holding companies may engage in "(A) . . . banking . . . *and* (B) those [activities] permitted under [section 4(c)(8)]" (emphasis added).

There is no support for the theory that Congress intended to place any nontextual limitation on the Board's authority under section 4(c)(8) of the Bank Holding Company Act, let alone a limitation derived from section 19(e) of the Glass-Steagall Act. The best guide to the intention of Congress in enacting the Bank Holding Company Act is the language that Congress used. That language broadly empowers the Board to authorize bank holding companies to engage in activities that it determines to be closely related to banking. It does not require the Board to treat activities involving securities differently from other activities. The court of appeals was unable to point to evidence in the legislative history that is incompatible with the undifferentiated authority conferred by the language of section 4(c)(8). To the contrary, the court of appeals conceded that "the legislative history provides virtually no guidance" beyond the broad language that Congress used in delegating authority to the Board. Pet. App. A, p. 30a.

Nor does the history or content of section 19(e) of the Glass-Steagall Act support the suggestion that there existed an implied, nontextual limitation on the Board's authority. Section 19(e) was only a part (and a minor part at that) of a broader set of provisions in section 19, which required a bank holding company to meet certain conditions as a prerequisite to voting the shares of its banking subsidiaries. Section 19 "authorized the Board to regulate the financial and managerial soundness of bank holding companies and their banking subsidiaries." *Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. 234, 243 (1978). But because section 19 prescribed only a voting-permit procedure, and did not directly regulate or limit the activities of the holding company, it "ultimately proved of little value." *Id.* at 244. "[I]n 1966 Congress repealed [these] voting permit provisions . . . because it believed that the Board retained authority

under § 3(c) [of the Bank Holding Company Act] to ensure the financial and managerial soundness of holding companies and their subsidiary banks." 439 U.S. at 246.[43]

Thus, section 19 of the Glass-Steagall Act, even taken as a whole, played but a brief and ineffectual role in the regulatory scheme. By no stretch of the imagination can section 19 be viewed as affording special guidance to a determination of the extent of the Board's authority under section 4(c)(8) of the Bank Holding Company Act.

Moreover, section 19(e) itself simply barred a bank holding company from voting the shares of its banking subsidiary if the holding company also held an interest in a company "principally" engaged in the same activities that were described in section 20. Because the activities in which bank holding companies are permitted to engage by the Board's regulation do not trigger the prohibition of section 20, they would not have triggered the voting permit limitation of section 19(e).[44]

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[43] The court of appeals mistakenly asserted that "[t]he Senate Report, commenting on the repeal, noted that section 19(e) *'serve[d] no substantial purpose'* after passage of the 1956 Act." Pet. App. A, p. 32a (emphasis added by court of appeals; footnote omitted). In fact, the Senate Report did not cite section 19(e) or refer in any way to the securities activities described therein. The only reasons the Report gave for the repeal applied to section 19 as a whole, and those are the reasons discussed by this Court in *First Lincolnwood*. *See* S. Rep. No. 1179, 89th Cong., 2d Sess. (1966).

[44] The court of appeals appears to have believed that Congress employed the voting-permit procedure of section 19(e), and possibly also the "engaged principally" standard of sections 19(e) and 20, out of concern that the congressional power under the commerce clause did not allow more intensive federal regulation of state-chartered companies. Pet.

The court of appeals' approach has made a simple case complicated. That approach and the result to which it led are wrong. The plain language of section 4(c)(8) authorizes the Board to do what it did. Nothing in the legislative history of section 4(c)(8) imposes a non-textual constraint on the Board's power to authorize bank holding companies to engage in otherwise lawful securities-related activities. And the activities authorized by the Board's regulation are otherwise lawful, for nothing in the text or the policy of the Glass-Steagall Act prohibits bank holding companies from organizing and managing closed-end investment companies in the manner authorized by the Board's regulation.

App. A, pp. 25a-28a. Whether or not Congress was influenced by that consideration is immaterial. What is of paramount significance is that Congress drew the lines that it did. The fact is that section 19 was only a voting permit procedure; it may not now be judicially resurrected as an outright prohibition against the activities described therein. Nor may the distinction marked by the "engaged principally" standard of both section 19(e) and section 20 be obliterated. *Board of Governors* v. *Agnew*, 329 U.S. at 447-48.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted,

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